No. 8942

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ADOLPH BERNARD SPRECKELS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF.

WALTER SLACK,
Russ Building, San Francisco,
Attorney for Petitioner.

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The question presented is not as simple as the one posed by the respondent. It is not merely the incidence of the income tax on income of a trust paid to a beneficiary in the year of its receipt. Respondent ignores two factors, one, that the income in question was directed to be accumulated, the other, that petitioner was entitled to such accumulation only in the event he survived to the age of twenty-one. The presence of these factors is destructive of respondent's entire argument.

RESPONDENT'S ARGUMENT.

While respondent quotes subdivision (a) (1) of section 161 of the Revenue Act of 1932 under the

caption "Statutes Involved", its provisions are not thereafter referred to, but the argument is based upon the assumption that only subdivision (a) (2) of that section and subdivision (b) of section 162 are applicable.

The argument then, briefly, is that since the Supreme Court in *Blair v. Commissioner,* 300 U. S. 5, 81 L. ed. 465; *Helvering v. Butterworth,* 290 U. S. 365, 78 L. ed. 365; and *Freuler v. Helvering,* 291 U. S. 35, 78 L. ed. 634, has held that the test as to whether income of a trust is currently distributable, is whether or not there exists in the beneficiary the present right to receive the income; and since, it is asserted that, under certain California cases, the petitioner was entitled to receive the income; *ergo,* the income is taxable to petitioner.

CASES RELIED ON BY RESPONDENT.

Not one court case cited by respondent in support of his argument involves a trust for accumulation. *Blair v. Commissioner* held that the assignee of the beneficiary and not the beneficiary was taxable on the assigned income of a trust unrestricted as to time of payment. *Helvering v. Butterworth* is summarized on page 22 of the opening brief, where it is noted that "the beneficiaries had vested interests and were currently receiving the income of the trusts." *Freuler v. Commissioner,* involved the taxability to persons receiving income of a trust as life tenants, of amounts withheld from their income by the trustee as repre-

senting depreciation. In *Letts v. Commissioner,* 84 F. (2d) 760, the trust required the distribution of the net income at least semi-annually. The court held the question as to whether certain income was currently distributable was to be determined by the state court having jurisdiction of the trust. In *McCrory v. Commissioner,* 69 F. (2d) 688, the trust directed the distribution of the income "on or before December 31st of each year." In *United States v. Arnold,* 89 F. (2d) 246, trustees were allowed to recover income taxes paid on gains from sales made in 1928, which the state court held in 1932 should have been distributed to life tenants.

The decisions of the Board of Tax Appeals in *Appeal of Brown,* 9 B. T. A. 521, and *Appeal of Sparrow,* 18 B. T. A. 1, are discussed in the opening brief, pages 17 and 18, and add no weight to respondent's argument not afforded by the decision in the *Appeal of Roebling,* 28 B. T. A. 644, reversed by the Circuit Court of Appeals for the Third Circuit in *Roebling v. Commissioner,* 78 F. (2d) 444, and the decision in the present case.

PETITIONER HAD NO "VESTED" RIGHT TO INCOME.

From the quotation on page 13 of respondent's brief from the opinion in *Freuler v. Helvering,* and the subsequent citation of four California Supreme Court decisions hereafter referred to, it would appear that respondent has fallen into the error of regarding petitioner's interest in the income accumulated by the

trustees to October 29, 1932, as "vested", and as a corollary that he had a present right to receive it as it accrued. These California decisions, cited on page 16 of respondent's brief, are *Estate of Yates,* 170 Cal. 254, 258, 149 Pac. 555, 557; *Estate of Budd,* 166 Cal. 286, 293, 135 Pac. 1131, 1134; *Estate of Duffill,* 180 Cal. 748, 761, 183 Pac. 337, 342; *Goldtree v. Thompson,* 79 Cal. 613, 624, 22 Pac. 50, 53. In each case there was a devise or bequest of a fund or property with a direction to accumulate the income for a period, at the end of which the beneficiary received the accumulations and either then or later the principal. *There was no gift over.* On the death of the beneficiary the trust would terminate and the gift pass to his heirs. The court held in each case that the interest of the beneficiary was vested.

In the present case, as pointed out in the opening brief, pages 12 to 14, the petitioner took nothing until he reached the age of twenty-one. On his death prior to that time, others would take. In addition, *there was a gift over.* This difference, at least in California, is sufficient to make an interest such as petitioner's contingent. The court in the *Estate of Blake,* 157 Cal. 448, 459, 464, 108 Pac. 287, 292, 294, cited in the opening brief, after citing and quoting from *Estate of Rogers,* 94 Cal. 526, 530, 29 Pac. 962, says:

> "Hence in this state the rule is that a devise over is to be construed as indicating an intention on the part of the testator not to make a vested devise, and, applied to the devise here in question, imparts additional force to the conclusion

> which we think apparent from the language of the devise itself that only a contingent devise was made to Ethel Pomeroy; that it was only to take effect in title and possession on the condition of her attaining the age of thirty."

Petitioner had no present or vested interest in the income as it accrued, and was only entitled to receive what had accrued, when, fortuitously, he attained the age of twenty-one.

If the four California cases, cited on page 16 of respondent's brief, are cited to the proposition that the petitioner on attaining majority received the accumulations *qua* income, they do not support him. *Estate of Yates,* 170 Cal. 254, 258, 149 Pac. 555, 557, reads:

> "We conclude, therefore, that these trusts still continue for the period of time in them specified; that as each of the legatees attains his majority he is entitled to the *accumulations* and *to the later accruing income* of the trust fund." (Italics supplied.)

Petitioner's position on this point will be found on pages 19 to 21 of the opening brief.

WHETHER VESTED OR NOT, INCOME BEING ACCUMULATED BY TRUSTEES IS EXPRESSLY TAXABLE TO THE TRUSTEES.

The respondent's entire argument is beside the point however, since the ignored provisions of subdivision

(a) (1) of section 161 adequately cover the income in question whether vested or contingent, and the section requires that the income be taxed to the trustee. The statutory provisions read: "The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust including: (1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, *and income accumulated or held for future distribution under the terms of the will or trust;* * * *. *The Tax* shall be computed upon the net income of the estate or trust, and *shall be paid by the fiduciary,* * * *." (Italics supplied.) Here is the primary rule, and if such income is to be taxed to the beneficiary by reason of some other provision of the act, it is incumbent upon one so asserting to show such provision and that it is applicable without question. Respondent utterly fails to sustain such burden.

Whether or not the interest of the ultimate recipient of the accumulations is vested or contingent and whether or not the date of future distribution falls within the year are immaterial, since the statute expressly taxes the income to the fiduciary.

Petitioner anticipated respondent's argument as to the applicability of subsection (b) of section 162, on pages 14 to 19 of the opening brief, and will not repeat here the argument there made. It should be pointed out, however, that both this subsection and subdivision

(a) (2) of section 161, refer to income "which *is to be* distributed currently." The characterization is clearly of income, which by the terms of the instrument creating the trust, and upon the facts existing at the time of receipt, is to be so distributed. It is not an apt expression to designate income which at the time of receipt falls in the category of subdivision (a) (1), but which by the happening of subsequent events is thereafter actually paid to the beneficiary. To find an expression appropriate to respondent's contention, without doing violence to meaning and construction, the provision should have read "income which is distributed to the beneficiary during the current year."

The cases of *Roebling v. Commissioner,* 78 F. (2d) 444, and *Commissioner v. Simmon,* 198 N. E. 741, are squarely in point and an affirmance of the present decision of the Board will create a conflict with the *Roebling* case. The single fact that in the two cases, the principal of the trust was distributable to the beneficiary by the happening of the same contingency that made the accumulations distributable is utterly insignificant on the subject of the incidence of income taxation on the accumulations. (Opening Brief, pages 24 and 25.)

Several cases are cited by respondent which have not been reviewed here, since examination showed them so patently inapplicable as not to warrant further extension of this brief.

It is submitted the decision of the Board should be reversed.

Respectfully,

WALTER SLACK,

Attorney for Petitioner.

Dated, San Francisco,
November 18, 1938.